

**Country Sector Analysis**

**Mongolia Country Report**

**U.S. Commercial Service**

**European Bank for Reconstruction and Development**

## **COUNTRY SECTOR ANALYSIS**

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## **EBRD OPPORTUNITIES IN MONGOLIA**

Prepared by the Commercial Service Liaison to the European Bank for Reconstruction and Development

Mongolia is the newest addition to the EBRD's countries of operation, after being approved in July of 2006. Mongolia's GDP has seen steady growth in recent years, peaking at 10.6% in 2004. More than 25% of Mongolia's GDP is derived from extraction and processing of natural mineral resources. Mongolia has a liberal trade regime and commodity exports are an important source of income. The Mongolian Government welcomes foreign investment in the country and the business climate enjoys high levels of fiscal and financial freedom. Entrepreneurship is encouraged and it is relatively easy to start a new business in Mongolia. There are also high degrees of investment and trade freedom. The top income and corporate taxes are moderate. Relations between Mongolia and the United States are excellent. In recent years the US has contributed humanitarian aid and business development assistance while Mongolia has in turn committed peacekeeping forces to Iraq and Afghanistan. Mongolia's recent economic growth only shows signs of continuing.

### ***Mongolia Overview***

Mongolia is a Parliamentary Democracy headed by President Nambaryn Enkhbayar and Prime Minister Miyeegombyn Enkhbold. The nation's capital is Ulaanbaatar, which is also its most populated city. Mongolia has a total land area of 1,564,116 square kilometers (comparable to Alaska) making it the world's nineteenth largest country and the second-largest landlocked country. As of 2005 the population of Mongolia was estimated at 2,646,000 people. Thirty percent of Mongolians still lead nomadic or semi-nomadic lives. Mongolia is among the least densely populated nations in the world. It shares its northern border with Russia and its southern border with China. The predominant religion is Tibetan Buddhism. Per Capita GDP is \$2,175 (2005). Mongol currency is called the tugrik (MNT). The exchange rate as of March 28, 2007 is US\$ 1 = 1,162.00 MNT (tugriks), 1 EUR = 1,549.65 MNT, 1 GBP = 2,281.58 MNT.

### ***EBRD Strategy Overview for Mongolia***

The EBRD plans to focus on the development of private business in Mongolia. Specifically, the bank plans on encouraging the growth of agribusiness, tourism and infrastructure, property, services and, most importantly, natural resources in Mongolia. Personal relationships are critically important in the Mongolian business world. It is crucial that exporters, importers and investors establish and maintain close associations with their Mongolian business partners.

### *Financial Sector*

Supporting the financial sector in Mongolia is going to be a main priority of the Bank. The EBRD intends to encourage micro and small enterprise by making increased financing sources available through improved access to commercial banks.

Currently, the commercial banks have only limited access to term finance, which makes it difficult for customers of these banks to borrow on reasonable terms. This in turn makes the process of starting new businesses or expanding current operations difficult. The EBRD intends to improve access to finance through the provision of different forms of credit lines and debt products to commercial banks that meet the EBRD's financial and integrity criteria.

### *Infrastructure Development*

Mongolia has massive investment needs in infrastructure. Opportunities exist in the areas of aviation, telecommunications, and selected utilities. There is also the need for construction of new power and transport infrastructure to support development of the mining industry. Moreover, the Bank will investigate the potential for bankable renewable energy projects including hydro and wind power.

\*NOTE: As part of an IMF requirement the Mongolian public sector can only borrow if at least 35 per cent of the loan is provided on a grant basis. Local and regional authorities can only borrow from the central Government. Under these circumstances, the Bank will primarily focus on private sector operations, but will seek concessional and grant financing for the projects in the public sector.

### *Tourism*

Mongolia is quickly becoming a very attractive tourist destination and the prospects in this sector are growing. Mongolia offers a unique market that can cater to both adventure and cultural tourism, which are both rapidly growing in popularity. Visitors are drawn to Mongolia by attractions such as famous fossil discoveries, historic and religious sites, and the chance to see a thriving nomadic culture. The Mongolian government estimated that in 2004, more than 200,000 vacationers came. However, current tourist infrastructure is inadequate and in need of new investment and upgrading. The provision of upscale lodgings near cultural and environmental sights, the improvement of adjoining infrastructure, and the formation of companies that can guide tourists through Mongolia's natural attractions will be the focus of investment.

### *Construction*

The population in the Mongolian capital of Ulaanbaatar has more than doubled in the past 7 years from 450,000 to over a million people. There is a shortage of both commercial space and residential housing and demand shows no signs of slowing. By 2010, Ulaanbaatar's population is expected to grow by more than 60%, bringing a demand of 700,000 additional family units as well as increased need for expanding municipal facilities.

### *Mining*

Mongolia has enormous mineral reserves, which are very important for the future economic prosperity of the country. There are more than 6,000 deposits of 80 different types of minerals in Mongolia. This includes coal, copper, uranium, iron ore, oil, tungsten, molybdenum and phosphate. Most of these reserves are still largely untapped, and the financing of foreign and domestic enterprises involved in this sector is going to be another main priority of the EBRD. Mongolia's location next to China provides a ready market for these extracted minerals. The Bank will also support financing for the oil and gas sector. As with all industrial sectors in Mongolia, the developing infrastructure is a concern and the improvement of this sector is dependent upon the further growth of infrastructure and power.

The Bank's objectives in mining are:

- Setting high standards for business conduct and environmental protection
- Ensuring sustainability of the relatively young Mongolian natural resources sector
- Further commercializing and corporatizing the large state-owned mining companies
- Providing the skills needed to support the growth of a vibrant SME industry able to compete domestically and regionally.

### *Agribusiness*

Agriculture is a dominant sector of Mongolia's economy. Nearly a third of Mongolia's population lives in households that rely on herding as the primary source of subsistence. Currently the ownership of land and natural resources belongs to the state, and pastureland and other resources are provided free of charge to rural, semi-nomadic communities that are traditionally involved in livestock breeding activities.

Agribusiness Prospects:

- Vast herds of sheep and cattle in Mongolia
- High demand for meat products in neighboring countries - Russia, China, Korea, and Japan
- New meat processing and marketing technologies are needed

- Existing processing facilities require upgrading to increase production capacity, quality, and sanitation

The Bank plans to support successful processors of basic food items, and aims to raise quality and efficiency in the processing sector.

## ***Transport***

### *Aviation Sector*

The Mongolian Civil Aviation Authority has asked the EBRD to support runway rehabilitation of four domestic airports, and also to upgrade selected air navigation equipment. These projects are considered priority investments in the Banks plan for the sector, because of the impact this will have on flight safety and the positive development of tourism. The Bank will also support potential private sector opportunities in Mongolia in the area of private airline passenger operations and cargo services.

### *Road Sector*

Mongolia's road network spans 49,250 km, however, only 12% of this constitutes paved roads, with 13% being gravel, and 75% being dirt roads. Road density is very low at only 0.03 km per square km. The investment needs in the sector are enormous and of critical importance, because the further growth of industries such as mining and agribusiness are dependent on improved road infrastructure.

### *Railway Sector*

Ownership of the Mongolian Railways Company is split in half between the Mongolian State and the Russian Railways Syndicate. Due to this legal status the EBRD cannot directly finance rail projects until this sector is privatized. However, the Bank will seek opportunities to support the railways efforts with rolling stock renewal, improved track equipment, fleet expansion and infrastructure upgrade, if and when there is enough progress in the corporatization of the currently bi-nationalized rail company.

## ***Infrastructure***

### *Power*

The power and energy sector in Mongolia is in need of major investment in order to improve capacity and efficiency. The EBRD plans on financing rehabilitation projects of existing power transmissions as well as construction of new power lines to Western and Eastern power grids, and also to the South where power demand will soon be increasing very significantly due to exploration and operations of new mineral deposits. The Bank will also investigate the possibility

of renewable energy projects, such as medium size hydro or wind generation plants.

#### *Telecom*

The Bank plans on investigating the opportunity of acquiring shares in Mongolia's communications networks depending on their privatization. The mobile telephone sector is expanding rapidly at present. The Bank will try to identify opportunities to finance private sector companies using the all of the Bank's instruments from corporate loans to equity or mezzanine financing.

#### *Mongolia Cooperation Fund and TAM*

As of 2006, 8.9 million euros has been invested in 38 different projects through the Mongolia Cooperation Fund, which is managed by the EBRD. The objective of this fund is to support small and medium sized private businesses, and also to encourage development in financial institutions, infrastructure, and natural resources. The EBRD has also introduced its TurnAround Management Program (TAM) in Mongolia where experienced business leaders from around the world use their knowledge and expertise to help local companies.

#### ***Environmental Issues***

The EBRD has had a strict environmental policy since its inception and is committed to only financing projects that are environmentally sound and sustainable. To promote its environmental strategy, the Bank pursues four main goals:

- Integrate environmental considerations into every project.
- Promote environmentally oriented investments across all sectors.
- Incorporate the environmental mandate in all sector strategies.
- Build partnerships to address regional and global environmental issues.

#### *Socio-Economic Issues in the Mongolian Extractive Industry*

The formal mining sector in Mongolia currently employs roughly 12,000 people, however, the informal or 'artisan' mining sector involves many times this number. Both commercial miners and Mongolian Government officials have criticized these underground mining operations as environmental and health hazards.

Licenses to develop natural resources deposits are given by the Ministry of Industry and Trade without any prior consultation with local communities where the extraction will take place. Erosion of soil, contamination of rivers by heavy pollutants and general degradation of landscape has caused much concern to these communities, and tensions between mining companies and the local people affected by their activities is a growing issue.

As the mineral extraction industry expands in Mongolia, environmental, health, and social issues will become increasingly important. To address these concerns the EBRD will:

- Conduct comprehensive studies on potential projects in order to identify and address any environmental, socio-economic, worker protection and cultural heritage issues that could be associated with its activities.
- Work with its clients to develop environmental plans that are in accordance with international environmental, health, safety and labor regulations and best-industry practices.

The primary environmental concerns in Mongolia involve sustainable management plans for natural resources. The most pressing issues are:

- Damage to wetlands and waterways as a result of industrial mining.
- Desertification and overgrazing due to unsustainable herding practices.
- Air pollution caused by coal-based power generation plants and industry.

*Mongolian Environmental Legislation:*

The Mongolian Government has shown a strong desire to preserve their country's environmental integrity. 28 nature reserves have been established that currently cover 13.1% of the total land area in Mongolia. In order to sustain the existing range of wildlife species and ecosystems, the Ministry of Nature and Environment has set a target of 30 per cent of the total land area to be under protected areas, including national parks, by 2030.

Furthermore, in 1993 Mongolia developed its National Environmental Action Plan (NEAP), which aims to address environmental issues in the areas of desertification, forestry, biodiversity, water quality, and protection and conservation of rare species. Unfortunately, enforcement and implementation of NEAP has been poor due to financial problems. As a result the EBRD's own environmental policy will be critical for preserving environmental integrity in the region.

Mongolia is also party to the:

- Vienna Convention for the Protection of the Ozone Layer
- Montreal Protocol on Substances that deplete the Ozone Layer
- Convention to Combat Desertification
- Basel Convention on Control of Hazardous Wastes and their disposal
- Ramsar Convention on Wetlands Protection
- Kyoto Protocol



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